

Hello Everyone,

Six weeks ago, no one had heard of a coronavirus. I didn't even know what the word meant. So I looked it up:

***Coronavirus gets its name from a distinctive corona or 'crown' of sugary-proteins that projects from the envelope surrounding the particle. Encoding the virus's make-up is the longest genome of any RNA-based virus – a single strand of nucleic acid roughly 26,000 to 32,000 bases long.***

I'm not sure that helps my understanding much.

But since my beat is finance---and since Wall Street was reacting to every coronavirus rumor--I thought I should look for connections. The problem became determining rumor from fact...and the Chinese aren't much help.

Nonetheless, today's missive will try to ferret out some truth...even if we have to get there indirectly.

Signed, Your Glad-There-Are-Smart-People-Working-On-Cures Financial Advisor,

Greg

## **KKOB 02.07.2020 Coronavirus & Chinese Banking**

**Bob:** So, Greg, you and I haven't discussed the coronavirus yet. The problem I have is this. I don't know what's true. I don't trust any news coming out of China.

**Greg:** That's fair. I think we all know the Chinese government will exaggerate good news and suppress any bad news that reflects poorly on the Communist Party.

So, knowing this, is there an indirect way for you and your listeners to determine how bad the coronavirus situation is---and then determine how it might affect their investments?

Well, one way to get closer to the truth may be by connecting banking stocks with the coronavirus.

**Bob:** Ohh kaaayy. This is a connection I haven't considered. Let's hear the logic.

**Greg:** I know it sounds odd, but here goes. Several weeks ago the Chinese government issued an extensive report about the state of Chinese banks. It was mildly negative. Now, since it wasn't positive, you can guess the negative parts are probably far worse than they let on.

So, let's start with some basics.

- The total size of China's banking system is roughly \$40 trillion.
- That's more than twice the size of the US banking system.
- But, more importantly, China's banking system is more than three times the size of its entire economy.

**Bob:** Wait. How can the banking sector be larger than the entire economy? That tells me they have massive leverage...which is usually unstable.

**Greg:** You're not alone with that concern. So, let's put some numbers to that.

- If only 5% of the Chinese banking system required a bailout, that's the equivalent of nearly 20% of China's GDP. Even for China, that is a huge number.

Which leads to the logical question of, "What percent of China's banking is in trouble?"

According to their own report, 586 institutions are considered “high risk”. The exposure in just those banks could easily reach trillions of dollars.

And, some of the 586 are already failing. In the past several months, the Chinese have been forced to nationalize multiple banks. There have been bank runs in most provinces, and the Chinese have forced healthy banks to merge with failed banks to stop the possibility of financial contagion.

So, what are the underlying causes of all this? Again, by their own admission, corruption, theft, bad business practices, and poor underwriting have led to millions of bad loans. Add to that the inherent inefficiencies of communism (in conjunction with the trade tariffs) and it’s easy to see how their banking system is stressed.

**Bob:** I think I see where you are going with this. You started with the coronavirus. There is no way that virus is good for Chinese business. I mean if tens of millions of people are now in medical lock-down, that means they aren’t working. It’s hard to repay loans without income. So more defaults and bank failures are probably coming.

**Greg:** You’re thinking clearly. Keep going.

**Bob:** Well---every bank in the world has connections to China. So, if China suffers, there is the possibility of a ripple effect across the globe.

**Greg:** And where have you and I said the weakest banks in the world are?

**Bob:** Europe. And I know the stock price on Germany's biggest bank Deutsche Bank has gone from \$146 to \$9 per share and they have big ties to China.

So, you're saying the contagion of coronavirus isn't just biological, it could also be financial. Right?

**Greg:** Could is the right word. So how do we get closer to the facts, so we can make reasonable connections?

My experience has been money smells out truth faster than the politicians---and the news media. So, to me, a hint of whether the virus is under control (or not) could first show up in the performance of Chinese banking stocks...and then eventually (by extension) western banking stocks.

And, so far, there is no big sell off....which is good news. With that said, on Monday, I'll give you another "money take" which indicates there is some behind-the-scenes-panic going on over there.

**Bob:** Your mind thinks differently than most. Looking forward to Monday. How do people reach you?

**Greg:** My number is 250-3754 or just go to my website at [zanettifinancial.com](http://zanettifinancial.com).

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